Our Georgian Capital partner, Patrick Kim, is extensively quoted in today's The Globe and Mail article: "How to ratchet down risk without sacrificing returns" (see link below). A challenging subject in today's volatile markets.

Please read and enjoy. Comments welcome, as always.

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ADVISER CORNER

VOLATILITY

How to ratchet down risk without sacrificing returns

DALE JACKSON

Investors looking to contribute to their registered retirement saving plans (RRSPs) before the Feb. 29 deadline face a classic conundrum: risk losing money in these volatile markets or stay out and risk not having enough for retirement.

Even the experts grapple with the delicate balance between risk and reward, but there are ways to get the right mix.

Toronto-based Georgian Capital Partners specializes in squeezing out returns while letting its clients sleep at night. Partner Patrick Kim says annual returns of between 4 per cent and 9 per cent are attainable without taking on too much risk.

The first step is to avoid picking individual stocks hoping for winners, and use a broad portfolio strategy instead. "Look at your investments with a whole-portfolio perspective," he says. "Make sure you have diversity where, in any given environment, certain portions of your portfolio will be working."

Diversifying holdings is the best way to dilute overall risk while fanning out your portfolio for the next growth opportunity. Mr. Kim looks for what he calls "natural offsets" – two positions that generally move in opposite directions. "A good example is the price of oil to the U.S. dollar. They tend to move in inverse relationships," he says. His message hits home for investors heavily invested in energy stocks. "Make sure you have some companies that will benefit from a strong U.S. dollar because they [energy stocks and U.S. dollar stocks] tend to move in opposite directions."

Natural offsets are not easy to find in an interconnected global market, so Mr. Kim suggests covering all the bases by investing across sector lines such as financials, retail, technology, industrials and health care.

Mr. Kim describes the current stock market as a "grinding growth environment" where significant gains could be elusive for a long time. To compensate, he says investors should create a flow of cash from stocks that consistently pay and increase dividends. "Don't necessarily look for the highest growing stocks. Look for those companies that have the sustainable, visible cash flows that can continue to pay investors through regular dividends, and dividends that also happen to be growing," he says.

Dividend stocks in his portfolio include the big Canadian banks, which can pay annual yields of more than 5 per cent.

One of his favorite dividend stocks is EnerCare Inc., a company that rents water heaters to homeowners and currently pays a dividend of 5.5 per cent. "It has strong capital, a strong balance sheet and low debt," he says, adding that its low volatility makes it easy to sell if you need cash.

Other reliable dividend stocks in his portfolio are pipeline companies Inter Pipeline Ltd. and Keyera Corp., which pay 7.6 per cent and 4.3 per cent, respectively.

"You're going to take on some exposure to energy prices, but you've really seen a cleaver taken to some of the valuations on the pipelines," he says. "You're not seeing a drying up of volumes of the amount of oil that is going through the pipeline. Whether oil is $30 or $50 [a barrel, U.S.] it still has to get transported."

One investment Mr. Kim considers too safe are bonds, which base their yields on rock-bottom interest rates. "Very few investors are going to reach their long-term objectives by having a heavy weight in a 1-per-cent yield over 10 years," he says.

Shell-shocked investors looking for the ultimate in safety might talk with Simon Kay, president of Toronto-based IPS Insurance. He sells annuities – insurance products that guarantee fixed returns with the principal.

Mr. Kay says nervous investors, many of them oil patch refugees, have been approaching him in droves. "We're seeing wealthy people saying the roller coaster is too much to handle," he says.

Annuities are like defined-benefit pension plans. You receive a regular allowance for the rest of your life no matter what the markets do. "People love the idea of a defined-benefit pension plan because it takes all the guesswork out," he says. Annuities can be tailored to an individual's risk tolerance and return expectations. Returns from annuities are correlated to interest rates, which means the price of safety is relatively low returns these days.

Another drawback is their inability to capitalize on market rallies, and that's why Mr. Kay advises investors to put only a portion of their portfolio in an annuity. "It's a weird science where everything has a tradeoff of risk and reward," he says. "You end up in a position that says this is where my comfort zone is."

His advice for people trying to figure out what they need in an annuity is to start by determining how much cash they need in retirement. "Don't say I want to get 6- or 8-per-cent yield on my portfolio, but rather what do I need."

Mr. Kay says a typical payment on an annuity can be 4 per cent thanks, in part, to tax advantages. Investors who are concerned about increases in the cost of living can purchase annuities that are indexed to inflation. As rule of thumb, the greater the security, the lower the payout.

Regardless, he says you can't put a price on security. "All of a sudden this whole life-stress on their shoulders just goes away."

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